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DEPARTMENT PASS TREASURY AND DRB

EO. 11652: N/A

TAGS: ECON, UK

SUBJECT: ASSESSMENT OF THE PUBLIC EXPENDITURE WHITE
PAPER

REF: LONDON 2601; LONDON 2728; A-147 OF MARCH 4, L976

SUMMARY: THE WHITE PAPER IS THE PRODUCT OF A GOVERNMENT
SET ON BREAKING PAST TRENDS AND REFUTING THE INEVITABI-
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TY OF FURTHER ECONOMIC DETERIORATION. CONVINCED THAT FREEING RESOURCES FOR INVESTMENT AND EXPORT WHILE REINING IN BOTH PUBLIC AND PRIVATE CONSUMPTION IS THE NECESSARY FIRST STEP, THE GOVERNMENT HAS BEGUN A SINGLE-MINDED CAMPAIGN TO ATTRACT AND MAINTAIN THE SUPPORT AND COOPERATION OF ORGANIZED LABOR. INDUSTRY AND ESPECIALLY THE MAN IN THE STREET. SOME OF THE ASSUMPTIONS UNDERLYING THE WHITE PAPER GROWTH RATE PROJECTIONS HAVE BEEN MADE EXPLICIT, ALBEIT RELUCTANTLY, BY HM TREASURY. THEY MAKE POSSIBLE SOME CONCLUSIONS ABOUT THE KINDS OF POLICY MEASURES THE GOVERNMENT MAY HAVE TO INTRODUCE. IT IS OBVIOUS THAT THE POLITICAL WILL AND DETERMINATION OF THE GOVERNMENT WILL BE SEVERELY TESTED IN THE COMING YEARS AS IT ATTEMPTS TO CUT BACK THE GROWTH OF PUBLIC EXPENDITURE. THE WHITE PAPER IS A STATEMENT OF GOOD INTENTIONS, MANY OF WHICH COME LATER RATHER THAN SOONER. WHILE IT REMAINS TO BE SEEN IF THESE CAN BE FULFILLED, THIS SHOULD NOT DETRACT FROM CREDITING THE GOVERNMENT AND THE CHANCELLOR FOR AT LEAST MATCHING THEIR PROMISES WITH A FIRM STATEMENT OF POLICY. END SUMMARY.

INTRODUCTION -- THE GOVERNMENT'S INTENTIONS

1. THE PUBLIC EXPENDITURE WHITE PAPER IS IN EFFECT THE SPENDING SIDE OF THE GOVERNMENT'S BUDGET. MAIN POINTS MADE IN THE WHITE PAPER ARE THAT DURING THE PAST THREE YEARS PUBLIC EXPENDITURE HAS GROWN BY NEARLY 20 PERCENT IN VOLUME WHILE OUTPUT HAS RISEN BY LESS THAN 2 PERCENT. MOREOVER, THE RATIO OF PUBLIC EXPENDITURE TO GDP HAS RISEN FROM 50 TO 60 PERCENT; 15 YEARS AGO IT WAS ONLY 42 PERCENT. THE TAX BURDEN HAS ALSO GREATLY INCREASED, INCLUDING THAT FOR INDIVIDUALS WITH AVERAGE AND BELOW AVERAGE EARNINGS. TAX THRESHOLDS HAVE FALLEN SHARPLY AND PEOPLE ARE NOW PAYING TAX AT INCOME LEVELS WHICH ARE BELOW SOCIAL SECURITY BENEFIT LEVELS

2. THE TAX BURDEN IN RECENT YEARS WOULD HAVE BEEN EVEN LARGER IF THE GOVERNMENT HAD NOT ACCEPTED A HIGH PUBLIC SECTOR DEFICIT TO SUSTAIN EMPLOYMENT, BUT AS RECOVERY PROCEEDS THE PUBLIC SECTOR DEFICIT MUST BE PROGRESSIVELY REDUCED. AS WORLD DEMAND PICKS UP, MORE RESOURCES -- CAPITAL AS WELL AS MANPOWER -- WILL BE NEEDED FOR EXPORTS AND LIMITED OFFICIAL USE

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INVESTMENT. UNLESS THE UK IS PREPARED TO SEE RISING TAXATION REDUCE TAKE HOME PAY, THESE RESOURCES CAN BE MADE AVAILABLE ONLY BY KEEPING PUBLIC EXPENDITURE AT ROUGHLY THE SAME REAL LEVEL FOR SEVERAL YEARS. CHANGING THE STRUCTURAL DISTRIBUTION OF RESOURCES IS THE ONLY MEANS OF RESTORING AND MAINTAINING FULL EMPLOYMENT.

3. FUTURE IMPROVEMENT IN LIVING STANDARDS WILL DEPEND ON UK INDUSTRY GENERATING THE OUTPUT AND OVERSEAS SALES NECESSARY TO MAKE THE IMPROVEMENTS POSSIBLE. NORTH SEA OIL WILL MAKE AN IMPORTANT DIFFERENCE BUT IT WILL NOT BE BIG ENOUGH BY ITSELF NOR FULLY DEVELOPED SOON ENOUGH TO PROVIDE SUFFICIENT ADDITIONAL RESOURCES OVER THE NEXT FEW YEARS. THEREFORE, PRODUCTIVITY IN OTHER INDUSTRIES MUST BE IMPROVED.

4. THE GOVERNMENT PLANS TO STABILIZE THE LEVEL OF RESOURCES TAKEN BY ITS EXPENDITURE PROGRAMS AFTER THE NEXT 1976/77 FISCAL YEAR BEGINNING APRIL 1. IF THIS IS ACHIEVED, PUBLIC EXPENDITURE WILL FALL AS A PROPORTION OF NATIONAL OUTPUT FROM ITS CURRENT 60 PERCENT TO 53 PERCENT

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BY 1980. THE TAX BURDEN WILL STILL INCREASE BUT BY A MAN-AGEABLE AMOUNT. WITHIN TOTAL PUBLIC EXPENDITURE A HIGH-ER PRIORITY WILL BE GIVEN TO EXPENDITURE WHICH IS DESIGNED TO MAINTAIN OR IMPROVE INDUSTRIAL CAPABILITY AND GIVE THE ECONOMY A BETTER CHANCE OF SUCCESS. IN THE COMING FISCAL YEAR, CASH CEILINGS WILL BE IMPOSED ON ABOUT 76 PERCENT OF GOVERNMENT SPENDING. THESE ARE DESIGNED TO PERMIT THE TREASURY BETTER TO MONITOR THE RATE OF SPENDING THAN UNDER THE PRESENT SYSTEM WHICH ONLY REVEALS TOTAL SPENDING

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SEVERAL MONTHS AFTER THE FACT. THE CURRENT IMPROVEMENT IN THE RATE OF PRICE INFLATION SHOULD PREVENT REPETITIONS OF THE LARGE COST OVERRUNS IN PROGRAMMED EXPENDITURE THAT HAVE OCCURRED OVER THE PAST TWO YEARS. THIS WILL PROVIDE A MORE FAVORABLE ENVIRONMENT FOR THE INTRODUCTION OF CASH LIMITS. WHILE THE SYSTEM IS LIKELY TO CONTROL ONE SOURCE OF INFLATION, ANY LASTING SOLUTION TO THE PROBLEM OF RISING COSTS DEPENDS ON A CONTINUING TREND TOWARD LOWER WAGE SETTLEMENTS.

5. THE ARITHMETIC IN THE WHITE PAPER IS NOT TOTALLY CLEAR, IN PART BECAUSE MANY OF THE TABLES ARE NOT COMPARABLE. SOME ARE BASED IN VOLUME TERMS AT 1975 SURVEY PRICES (THOSE GENERALLY IN OPERATION IN THE FOURTH QUARTER OF 1974); OTHER TABLES ARE GIVEN IN COST TERMS BASED ON 1975-76 FISCAL YEAR PRICES. WHAT THEY DO SHOW IS THAT BEFORE PROVISION FOR DEBT INTEREST, CONTINGENCY RESERVE, AND SHORT FALLS, THE FORECAST TOTAL COST OF PUBLIC EXPENDITURE PROGRAMS IN THE 1976-77 FISCAL YEAR WILL DECLINE BY 1.2 PERCENT OVER THE 1975-76 LEVELS; LOOKING FURTHER AHEAD THE TOTAL PROGRAM EXPENDITURE IN VOLUME TERMS IN FISCAL YEAR 1979-80 WILL BE 3.6 PERCENT BELOW THE 1975-76 LEVELS. HOWEVER, WHEN PROVISION IS MADE FOR DEBT INTEREST, CONTINGENCY RESERVE AND SHORT FALLS, PUBLIC EXPENDITURE IN 1976-77 INCREASES BY 2.6 PERCENT AND IN 1979-80 BY 4.2 PERCENT OVER THE 1975-76 LEVELS (THE ABOVE FIGURES ARE BASED ON 1975 SURVEY PRICES). IT MUST ALSO BE NOTED THAT THESE PLANS FOLLOW ON CONSIDERABLY HIGHER THAN EXPECTED PUBLIC EXPENDITURE IN 1975-76.

6. THE REAL BITE IN THE PROGRAM WILL NOT BE FELT UNTIL THE 1977-78 FISCAL YEAR. DURING THE NEXT THREE YEARS

THERE WILL BE NO GROWTH IN REAL TERMS IN PUBLIC EXPENDITURE (EXCLUDING DEBT INTEREST AND THE CONTINGENCY RESERVE) BEYOND THAT NOW PLANNED FOR THE 1976-77 FISCAL YEAR. THE GOVERNMENT INTENDS THAT THE INCREASE IN NATIONAL OUTPUT DURING THESE YEARS SHOULD NOT BE APPROPRIATED FOR USE IN THE PUBLIC SECTOR BUT INSTEAD BE AVAILABLE FOR EXPORTS, IMPORT SUBSTITUTES, INCREASED PRODUCTIVE INVESTMENT, AND A MODEST RATE OF INCREASE IN PRIVATE CONSUMPTION. THE GOVERNMENT'S AIMS OF IMPROVING INDUSTRIAL LIMITED OFFICIAL USE

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TRIAL PRODUCTIVITY ARE SUPPORTED BY SUBSTANTIALLY HIGHER PUBLIC EXPENDITURE IN THE TRADE, INDUSTRY AND EMPLOYMENT PROGRAMS. MUCH OF THE EXPENDITURE WILL ASSIST INDUSTRIAL INVESTMENT ALTHOUGH IF SUPPORTED BY PUBLIC FUNDS, SUCH INVESTMENT, WHETHER BY PRIVATE OR PUBLIC ENTERPRISE WILL BE EXPECTED TO BE EFFICIENT AND COMPETITIVE.

7. THE UNSTATED BUT RECENTLY ADMITTED GOALS OF THE WHITE PAPER ARE A REDUCTION IN THE LEVEL OF UNEMPLOYMENT TO ABOUT 3 PERCENT (650 000,000) AND THE ATTAINMENT OF CURRENT ACCOUNT EQUILIBRIUM BY 1979. TOTAL PUBLIC EXPENDITURE IS PLANNED TO INCREASE AT AN AVERAGE ANNUAL RATE OF 1.0 PERCENT FROM THE BASE YEAR OF 1974. GIVEN THE EMPLOYMENT AND BALANCE OF PAYMENTS GOALS TOGETHER WITH THE LEVEL OF INTENDED GOVERNMENT EXPENDITURE, THE WHITE PAPER SETS FORTH THREE ILLUSTRATIVE CASES DESCRIBING REAL AVERAGE ANNUAL GROWTH AND USE OF THE ADDITIONAL RESOURCES IN THE ECONOMY THROUGH 1979. THE GROWTH RATES POSITED ARE 2.4, 3.4 AND 3.8 PERCENT, RESPECTIVELY.

8. THE CENTRAL CASE BASED ON A GROWTH RATE OF 3.4 PERCENT. SHOWS THE FOLLOWING BREAKDOWN OF THE MACROECONOMIC AGGREGATES DURING THE PERIOD 1974-1979:

AVERAGE ANNUAL GROWTH OF --

- 1) PERSONAL CONSUMPTION 1.8 PERCENT
- 2) PRIVATE INVESTMENT (INCLUDING INVENTORIES) 8.7 PERCENT
- 3) NATIONALIZED INDUSTRY INVESTMENT 4.0 PERCENT
- 4) PUBLIC EXPENDITURE 1.0 PERCENT
- 5) AVERAGE CURRENT ACCOUNT SURPLUS (1970 PRICES) 560 MILLION POUNDS

9. THERE HAS BEEN SOME DEBATE ABOUT THE PLASIBILITY OF THESE FIGURES. IN THIS AREA, MAJOR CONTROVERSY REVOLVES AROUND HM TREASURY'S RELUCTANCE TO PROVIDE MANY

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OF THE KEY ASSUMPTIONS ON WHICH THEY ARE BASED. BY FAR, THE BULK OF THE CRITICISM LEVELLED AT THE AUTHORS OF THE WHITE PAPER IS BASED ON THE PROJECTED CHANGES IN INDIVIDUAL GOVERNMENT SPENDING PROGRAMS WHICH LIE BEHIND THE DECISION TO HOLD THE AVERAGE ANNUAL INCREASE IN PUBLIC SPENDING TO 1 0 PERCENT.

10. CONSUMER EXPENDITURE COMMITTEE HEARINGS. THE MOST DETAILED CRITICISM TO DATE HAS BEEN PREPARED AT THE RELIMITED OFFICIAL USE

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QUEST OF THE HOUSE OF COMMONS EXPENDITURE COMMITTEE BY CAMBRIDGE UNIVERSITY ECONOMIST TERRY WARD, WHO MAKES AN EDUCATED ATTEMPT TO UNCOVER THE ECONOMIC ASSUMPTIONS UNDERLYING THE WHITE PAPER AND TO MAKE SOME JUDGMENTS AS TO WHETHER THE DISAGGREGATED FIGURES OF THE CENTRAL CASE ARE CONSISTENT BOTH WITH THOSE ASSUMPTIONS AND THE EMPLOYMENT AND BALANCE OF PAYMENTS GOALS. HE CONCLUDES THAT TO ACHIEVE THE FIGURES IN THE CENTRAL CASE WILL REQUIRE THE BRITISH ECONOMY TO MAINTAIN, OVER A 4-YEAR PERIOD, AN AVERAGE ANNUAL GROWTH RATE OF 4.8 PERCENT, SOME 50 PERCENT ABOVE THE LONG-TERM TREND. WARD CRITICIZES THE FAILURE TO MAKE EXPLICIT UNEMPLOYMENT AND BALANCE OF PAYMENTS TARGETS. IN RESPONSE TO THESE CRITICISMS, HM TREASURY WITNESSES AT PUBLIC EXPENDITURE SUBCOMMITTEE HEARINGS THIS WEEK, HAVE ADMITTED THAT ACHIEVING THE CASE II GROWTH RATE DEPENDS IN PART ON AN ASSUMPTION OF A 7.5 TO 8 PERCENT AVERAGE ANNUAL GROWTH IN EXPORT VOLUME (NOT IMPOSIBLE AFTER A 6.6 PERCENT AVERAGE GAIN DURING THE 1967-74 PERIOD) WHAT IS NOT ADMITTED IS THAT CURRENT ACCOUNT EQUILIBRIUM IS THEN DEPENDENT ON A 5-6 PERCENT RATE OF GROWTH IN THE VOLUME OF IMPORTS WHICH IMPLIES AN IMPORT ELASTICITY OF DEMAND OF ABOUT UNITY, CONSIDERABLY LOWER THAN THE GENERALLY ACCEPTED LEVEL OF 1.5 TO 1.8.

11. ACHIEVING THE GOVERNMENT'S UNEMPLOYMENT GOAL ALSO REQUIRES MAINTAINING A HIGHER THAN USUAL RATE OF GROWTH HERE, HOWEVER, THE CHANCELLOR HAS ABANDONED A COMMITMENT TO ANY SPECIFIC FIGURE CHOOSING RATHER AN APPROXIMATE PERCENTAGE (3 PERCENT) GOAL WHICH IS CONSISTENT WITH AN UNEMPLOYMENT TOTAL OF 650 TO 900,000 IN 1979 DEPENDING ON THE RATE OF GROWTH IN THE LABOR FORCE.

12. THE PROVISION FOR DEBT INTEREST AND CONTINGENCY FUND FIGURES HAVE ALSO ATTRACTED MUCH ATTENTION. PROVISION FOR DEBT INTEREST RISES TO 7.5 BILLION POUNDS (1975 SURVEY PRICES) BY THE 1979-80 FISCAL YEAR. THIS IS SOME 3.3 BILLION ABOVE THE LEVEL PLANNED IN LAST YEAR'S WHITE PAPER. IN RESPONSE TO WARD'S CONTENTION THAT THIS FIGURE CAN ONLY BE ACHIEVED BY MAKING SOME EXTREME ASSUMPTIONS ABOUT THE LEVEL OF FUTURE GOVERNMENT BORROWING REQUIREMENTS, THE LEVEL OF INTEREST RATES OR BOTH, TREASURY WITNESSES ADMITTED THAT THE WHITE PAPER ESTIMATE HAS ERRED ON THE SIDE OF CAUTION
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13. IN ADDITION, THE CONTINGENCY FUND RESERVE DOUBLES FROM 700 MILLION TO 1.4 BILLION POUNDS DURING THE SURVEY PERIOD. THIS PROVIDES SCOPE FOR THE GOVERNMENT TO INTER-

VE IN CHRYSLER-TYPE SITUATIONS SHOULD THEY ARISE OR TO MAKE ADJUSTMENTS TO PROGRAMS AS THEY NEED ARISES. THE 3 RECENT EMPLOYMENT PACKAGES PUT IN PLACE BY THE CHANCELLOR REPRESENT CLAIMS ON THE CONTINGENCY FUND.

14. GENERAL ASSESSMENT. THE OPTIMISM INHERENT IN THE WHITE PAPER'S CENTRAL CASE IS BASED LARGELY ON THE GOVERNMENT'S CONVICTION THAT ITS INDUSTRIAL STRATEGY OF STIMULATING INVESTMENT AND IMPROVING THE COMPETITIVE POSITION OF BRITISH PRODUCERS WILL MAKE AN INCREASING CONTRIBUTION TO ECONOMIC GROWTH OVER THE REST OF THE DECADE. THIS BELIEF IN THE ABILITY TO ACHIEVE HIGHER THAN AVERAGE ECONOMIC GROWTH IS ALSO BUTTRESSED BY THE EXISTENCE OF CONSIDERABLE EXCESS CAPACITY IN THE ECONOMY. THE WHITE PAPER REPRESENTS THIS GOVERNMENT'S ADAMANT REFUSAL TO ACCEPT THAT 30 YEARS OF STAGNATION AND DECLINE FORECLOSES ANY CHANCE OF REVERSING THAT TREND. SUCH A PROJECTION OF POSITIVE THINKING HAS ELICITED CONSIDERABLE SKEPTICISM FROM POLITICIANS AND ECONOMIC FORECASTERS. NEVERTHELESS, THE EVENTS OF THE PAST NINE MONTHS HAVE WITNESSED A CHANGE IN THE ATMOSPHERE WHICH, IF CONTINUED FOR ANOTHER YEAR OR SO, MAY CHANGE MANY OF THE UNDERLYING ASSUMPTIONS OF BRITISH ECONOMIC LIFE.

15. HAVING SAID THAT, THERE ARE SEVERAL MORE SPECIFIC INFERENCES THAT MAY BE DRAWN FROM THE WHITE PAPER. FIRST THE IMPLICIT LOW LEVEL OF IMPORT GROWTH COULD PRESAGE EITHER WIDER IMPORT CONTROLS OR MEASURES TO REDUCE DISPOSABLE PERSONAL INCOMES. THIS MAY BE PART OF THE EXPLANATION FOR THE CHANCELLOR'S REFERENCE TO A POSSIBLE NEED FOR A "MANAGEABLE" INCREASE IN TAXES LATER IN THE SURVEY PERIOD. SECONDLY, THE UNEMPLOYMENT TARGET OF 3

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PERCENT BY 1979 IS CONSIDERABLY LESS AMBITIOUS THAN THE
TRADE UNIONS CONGRESS GOAL OF 600,000 BY END-1978. HOW-
EVER, THE 3 PERCENT TARGET MAY BE SEEN AS A BARGAINING
CHIP IN THE UPCOMING NEGOTIATIONS OVER THE NEXT PHASE OF
INCOMES POLICY. FINALLY, WHILE THERE IS NO SPECIFIC RE-
LATIONSHIP BETWEEN THE LEVEL OF PUBLIC EXPENDITURE AND
THE LEVEL OF TOTAL INVESTMENT, THE GOVERNMENT'S INTENTION
TO STABILIZE PUBLIC EXPENDITURE FOR AT LEAST THREE YEARS
WILL ENLARGE THE SHARE OF TOTAL RESOURCES AVAILABLE FOR
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PRIVATE INVESTMENT.

16. THE GOVERNMENT MUST BE GIVEN FULL CREDIT FOR ITS
STATED POLICY OBJECTIVES. HOWEVER, THE OBJECTIVES MUST
BE TAKEN WITH A GRAIN OF SALT. THE MORE DETAILED PRO-
GRAM TARGETS (OUTLINED IN TABLES IN LONDON A.147) ARE
BOUND TO BE CHANGED OVER TIME. THE GOVERNMENT'S POLITICAL
WILL TO ACHIEVE THE OBJECTIVES WILL COME UNDER INCREASING
PRESSURE AS UNEMPLOYMENT CONTINUES TO RISE IN THE FIRST
HALF OF 1976 AND CONTINUES TO STAY AT HIGH LEVELS THROUGH
1977. MOST BETTING MEN WOULD RATE THE PROBABILITIES OF
THE GOVERNMENT MEETING ITS TARGETS AT LESS THAN EVEN MON-
EY. THIS SAID, AND VIEWED IN A LARGER CONTEXT OF OVERALL
POLICY OBJECTIVES -- THEY WOULD STILL APPLAUD THE AIMS
OF REDUCING THE GOVERNMENT'S TAKE OF NATIONAL PRODUCT,
FOSTERING THE INTERNATIONALLY VIABLE INDUSTRIES AND CON-

TINUING TO HOLD DOWN CONSUMPTION TO FREE RESOURCES FOR
EXPORTS AND INVESTMENT.

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